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The Conference Board

Worldbusiness Perspectives No. 69
October 1982

THE PRODUCTIVITY CONNECTION IN U.S. FOREIGN TRADE

Has the United States lost forever the productivity lead that it traditionally enjoyed over other industrial nations? As a corollary, is it doomed to suffer a continued undercutting of its one-time dominant foreign trade position? That there is a connection between industrial productivity and the capability to compete in world markets is undeniable. How well one can trace and quantify that connection, however, is less certain.

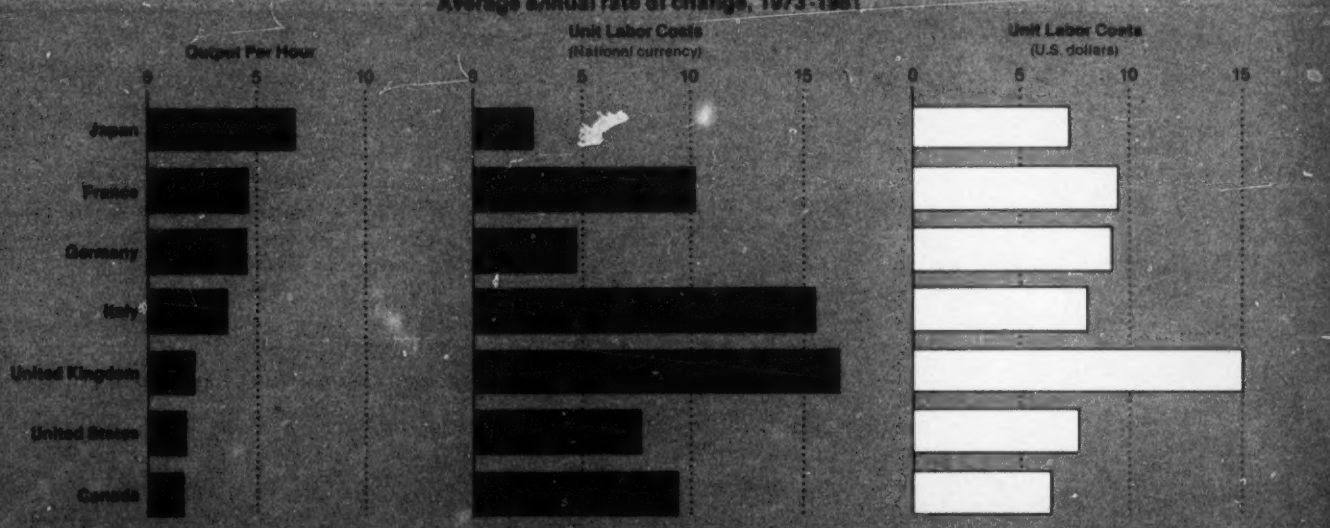
The comparatively poor record in the rate of productivity growth (output per hour) since 1973 in United States manufacturing is clearly revealed in the available statistics (see chart below). Of the seven countries shown, the United States ranks next to the bottom. Only Canada, with a 1.6 percent rate of productivity growth, ranked lower. At the other extreme, Japan showed an average annual increase of 6.8 percent, exactly four times that recorded in the United States.

As significant as productivity growth is in determining international competitive capability, it is not the whole story. With respect to money costs, the United States record is much better than its productivity one, but even here there is room for improvement. Unit labor costs, expressed in national currencies, for example, advanced by 7.7 percent a year in the United States during 1973-1981, a pace under all but Japan and Germany, countries with annual rates of 2.7 percent and 4.7 percent, respectively.

The U.S. record is even better when the comparison for unit labor cost is made in terms of dollars. The appreciation of the deutsche mark and the yen against the dollar during this period resulted in a faster recorded increase for Germany and Japan. As a matter of fact, unit labor costs in Japan, when expressed in dollars, advanc-

Manufacturing Productivity and Labor Costs

Average annual rate of change, 1973-1981



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ed almost as fast as those in the United States; 7.2 percent there as compared to 7.7 percent in this country.

Comparative Cost Position of the United States

The United States international cost position, consequently, was somewhat better at the end of 1981 than it was in 1973, despite the poor productivity performance in manufacturing. In other words, the relatively poor record of United States manufacturing in "real" terms was more than offset by monetary developments—that is, by relatively moderate wage-cost inflation and by a selected weakening of the dollar internationally.

The U.S. foreign trade balance of manufactures during this period in large part reflected the overall favorable cost position. In only two years, 1973 and 1978, was an excess of imports over exports of manufactures registered.

The full significance of this drop in the growth of manufacturing productivity has not been fully analyzed. Nor has it been well explained, although there is no shortage of possible causes advanced to explain the slowup. All probably have some validity but assessment is difficult.

Whatever may be the underlying causes, one development, clearly evident from Chart 2, is that the year 1973 marked a breakingpoint for all major industrial countries in the pattern of productivity growth. All seven industrial countries, not the United States alone, show a marked slowdown in output per manhour in 1973-81 over the 1960-73 period. This marked slowdown has been accompanied by an acceleration of the growth of unit labor costs, whether measured in national currencies or in dollars. This similarity of behavior may rest upon similar underlying causes, but much more analysis is required to established this point.

In some cases—Canada, for example—the productivity slowdown is sharper than in the United States. In others—notably France and Germany—the productivity slowdown has been comparatively moderate. Even Japan has seen its mignificent past record tarnished somewhat with a drop to a 6.8 percent average annual increase in 1973-1981, as against a 10.7 percent level for the earlier period. The drop in the Japanese rate suggests that it is not invulnerable to adverse economic forces, but it has been able to maintain its growth rate to such extent that its margin over the United States was enlarged rather than reduced in the more recent period.

Partial Explanation of Productivity Slowdown

How can the general slowdown, starting more or less at the same time in the principal industrial countries, be explained? The principal immediate explanation appears to be the decline in the rate of growth of total output. In all countries, the somewhat hectic growth in manufacturing output of the 1960-1973 period had been succeeded by a more sedate pace during the 1973-1981 period. Some corresponding adjustments had taken place in reduced hours and employment, but evidently not to such a degree as to offset the falloff in production. Needless to say, those countries that had the best record in maintaining their productivity growth did so by offsetting the slowdown in output by declines in employment and hours of input.

As noted before, manufacturing output per hour was best maintained in France and Germany. Aggregate manufacturing output grew at a more reduced rate in 1973-1981 than in 1960-1973, but, since total hours and employment actually declined, the productivity levels of 1960-1973 were largely maintained. By contrast, when 973-1981 is compared with 1960-1973, the poor productivity record of the United States is due to the fact that employment and hours continued to climb despite the fact that output growth was cut very sharply.

A more remote cause of the more or less concurrent slowdown in the productivity growth rate in the seven countries was the two oil crises in the 1970's. It is likely that this factor operated in at least two ways. One was by fostering the broad economic slowdown already noted. The other was probably in a needed rearrangement of the whole manufacturing process, due to the high cost and reduced availability of oil a source of energy.

It should also be recognized that the statistics usually available on productivity and related series are almost exclusively aimed at showing changes over time; they do not, despite their title, purport to tell how many tons of steel, for example, are produced per labor-hour of input in each country. Rather, the commonly available indexes only tell how the output per labor-hour has changed from one period to another, whether for steel, shoelaces or canned soup. This is, of course, important information, but it cannot say much about the comparative level of productivity of one industry in contrast to another. More importantly, it does not throw much light upon the relative standings of countries with respect to individual products, and certainly not with respect to such a composite concept as "manufacturing."

When comparing productivity between countries, the character of the available statistics are especially important—and, at present, deficient. Whether the present deficiencies can ever be overcome is also questionable, although several efforts have been made in the past.

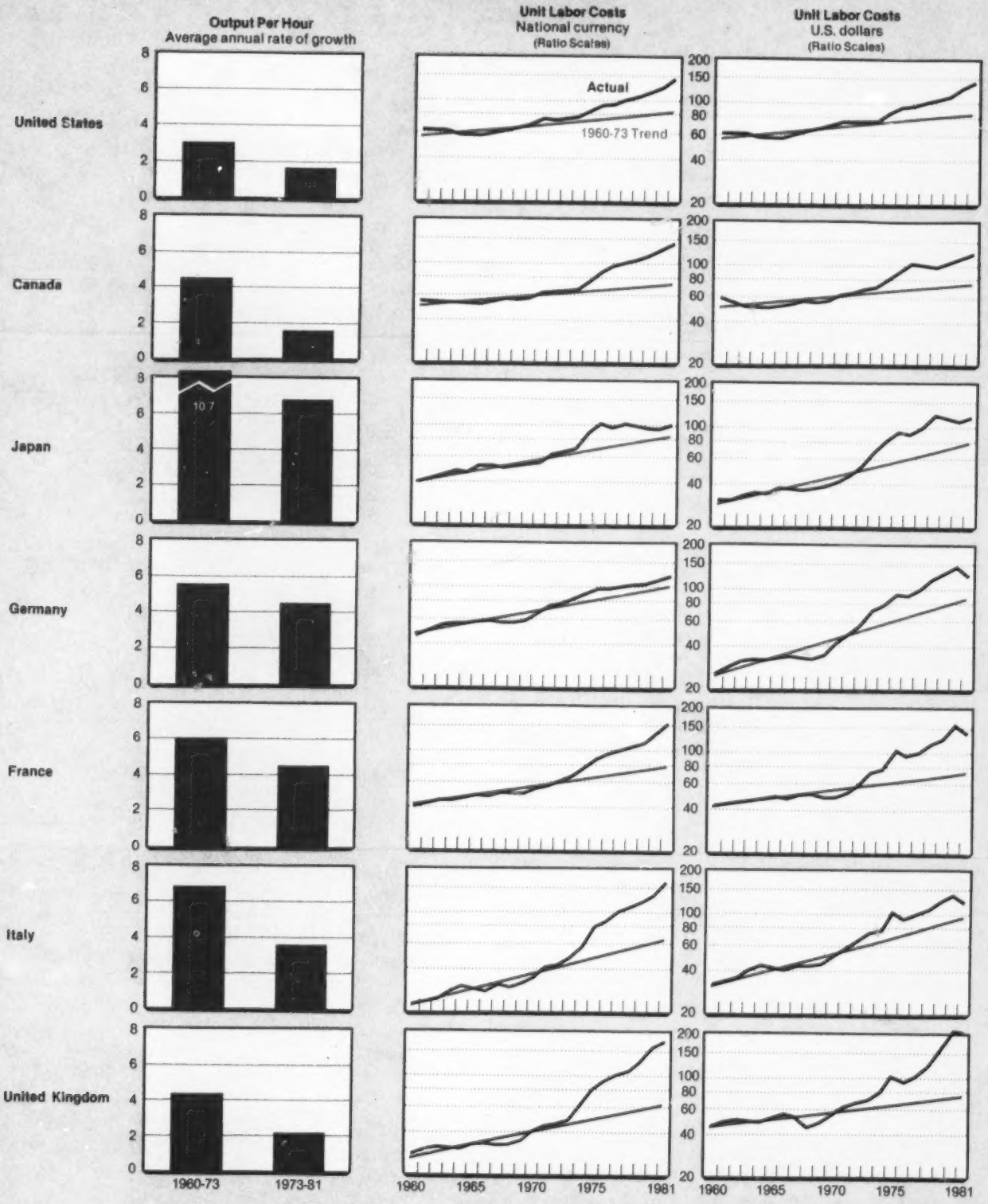
United States—A Longtime Laggard

It is a matter of record that when compared with other leading industrial countries the United States has been a laggard in manufacturing productivity for at

Output Per Hour and Unit Labor Costs in Manufacturing

The Break with the Past

1977 = 100



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least the last 30 years. The record is obviously not one to engender complacency. Despite this uninspiring performance, it still cannot be flatly stated that United States manufacturing is less productive in an absolute sense—that is, tons per hour, yards per hour, gallons per hour, or whatever yardstick is applicable to the particular manufacturing process.

Such an observation is not grounds for complacency. Even if it were true that the United States is still a leader in manufacturing productivity, the continuation of lagging growth would in time undermine its standing.

An illustration will make this clear. For the period 1960-1981 productivity increased in the United States by an average annual rate of 2.6 percent; the corresponding increase for Japan, the country with the highest rate, was 9.2 percent. For the whole period of 21 years, manufacturing productivity in the United States was 171 percent of the 1960 level. The corresponding position for Japan in 1981 was 635 percent of the 1960 level. These percentages simply assume a compound rate of growth for each country for the 21 years. On a net basis, consequently, productivity in Japan increased faster than in the United States by a factor of 3.70 (635 divided by 171).

As already noted, this tells us nothing about the relative level in the two countries. These figures, however, can be used as a basis for speculation, as a means of assessing the comparative standing now and 21 years ago. If we assumed that, through some statistical ingenuity, we were able to estimate that manufacturing output per hour in Japan was 25 percent of that in the United States in 1960, what would be the relative standing today? Given the growth rates above, the answer is 93 percent. If we assumed that manufacturing output per hour in Japan was 50 percent of that in the United States in 1960, then the growth rates point to a relative level of 185 percent, Japan over the United States.

These numbers, of course, cannot be verified because of the lack of data. Moreover, as already indicated, the very concept of overall manufacturing productivity is hard to visualize since it requires the combining of so many different products in the two countries. This combining process is just about impossible unless it is carried out in money terms; in such terms the very idea of comparative productivity becomes murky.

The illustration does serve, however, to show the power of relative growth rates in productivity in changing the economic standing of countries over the relatively short period of 21 years. The illustration, it should be noted, is one of extremes; the United States having the lowest, and Japan the highest, record of productivity growth over the period.

Composition of the Manufacturing Sector

Still another factor to consider in evaluating the recent record of comparative manufacturing productivity among countries is the underlying composition of the sector. In attempting to assess the competitive international position of countries, manufacturing is the proper sector to emphasize. It is the one that produces the goods that can be traded internationally. But trading, of course, takes place in terms of specific goods that make up the manufacturing sector and, consequently, suggests the need to look at the productivity and the relative importance of the industries making up manufacturing. Overall, "manufacturing" productivity can be altered simply because of a shift in the importance of individual constituent industries. The productivity record of the shifting industry simply plays a larger or smaller role in determining the overall performance of manufacturing. Similarly, a change in the productivity performance of one industry can influence overall productivity even if no change takes place in its importance.

When comparing productivity among countries, these possible complications become important to examine. Differences in the course of overall manufacturing productivity may be due to the different makeup of the sector in each country.

With data currently available, it is possible only to suggest the importance of this consideration. The electrical equipment and supplies industry in both the United States and Japan had above-average rates of growth in output per hour during the period, 1960-1972. During that time, the importance of the industry as measured by hours of input, grew sharply in relative importance in Japan's manufacturing sector. The growth in the United Stateswas less marked. A sharp lift, consequently, was given to overall manufacturing productivity inJapan; in the United States, the lift given to overall manufacturing productivity was modest.

The relatively faster growth of high-productivity industries in Japan, however, by no means explains away the outstanding record of Japan and the relatively poor record of the United States. When the main individual subdivisions of manufacturing are compared in the two countries, Japan almost always comes out ahead.

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The Conference Board

Worldbusiness Perspectives No. 70
December 1982

FOREIGN CAPITAL EXPENDITURES BY U.S. COMPANIES
A Cutback for 1983?

Manufacturers are especially gloomy about the prospects for making plant and equipment expenditures abroad in 1983. Only one-quarter of the respondents to the latest (October, 1982) survey by The Conference Board expected to spend more abroad in 1983 than in 1982. This represents a sharp drop from the nearly 40 percent of the prior survey of April 1982, and is the lowest recorded percentage since the survey was started in 1971.

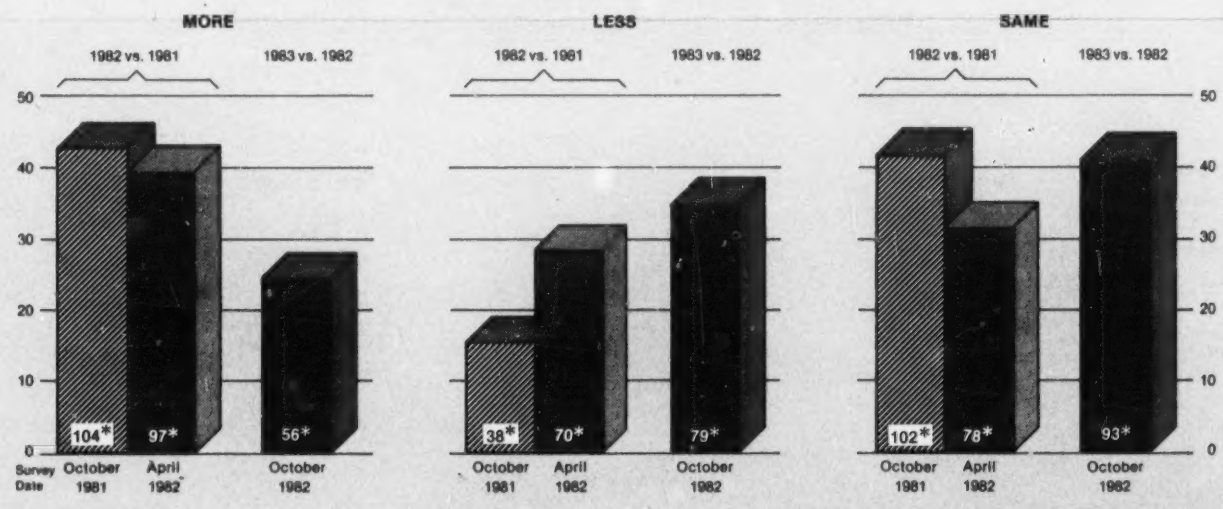
The current responses are a continuation of the disenchantment with foreign capital investment that goes back to the survey of April, 1979. Respondents reporting an intention to spend more abroad than in the previous year constituted a smaller percentage of the total in every successive semiannual survey since the one of April, 1979, (except for the one conducted in October, 1980).

The survey conducted by The Conference Board is aimed only at comparing current investment intentions with past levels on a company-by-company basis; it does not seek actual dollar magnitudes. For money expenditures one must turn to the last survey conducted in June, 1982, by the Department of Commerce. At that time, manufacturers (including petroleum) reported that they would be spending about the same in 1983 as in 1982. Given the pronounced reluctance of the respondents to the October, 1982, Conference Board survey to make investment expenditures abroad, it appears more than likely that dollar spending abroad on plant and equipment will show a dip from the year before, thus matching their announced intention for capital expenditures within the United States.

J. Frank Gaston

Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend:



* Number of Companies

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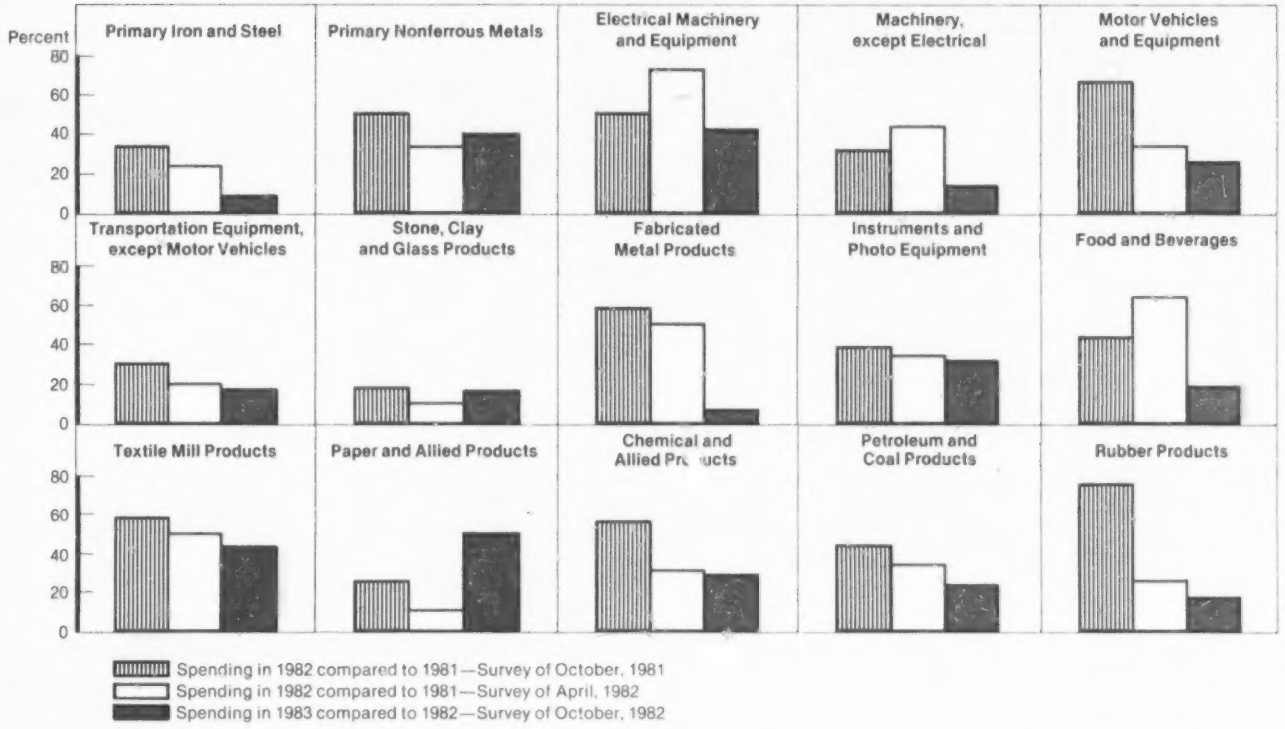
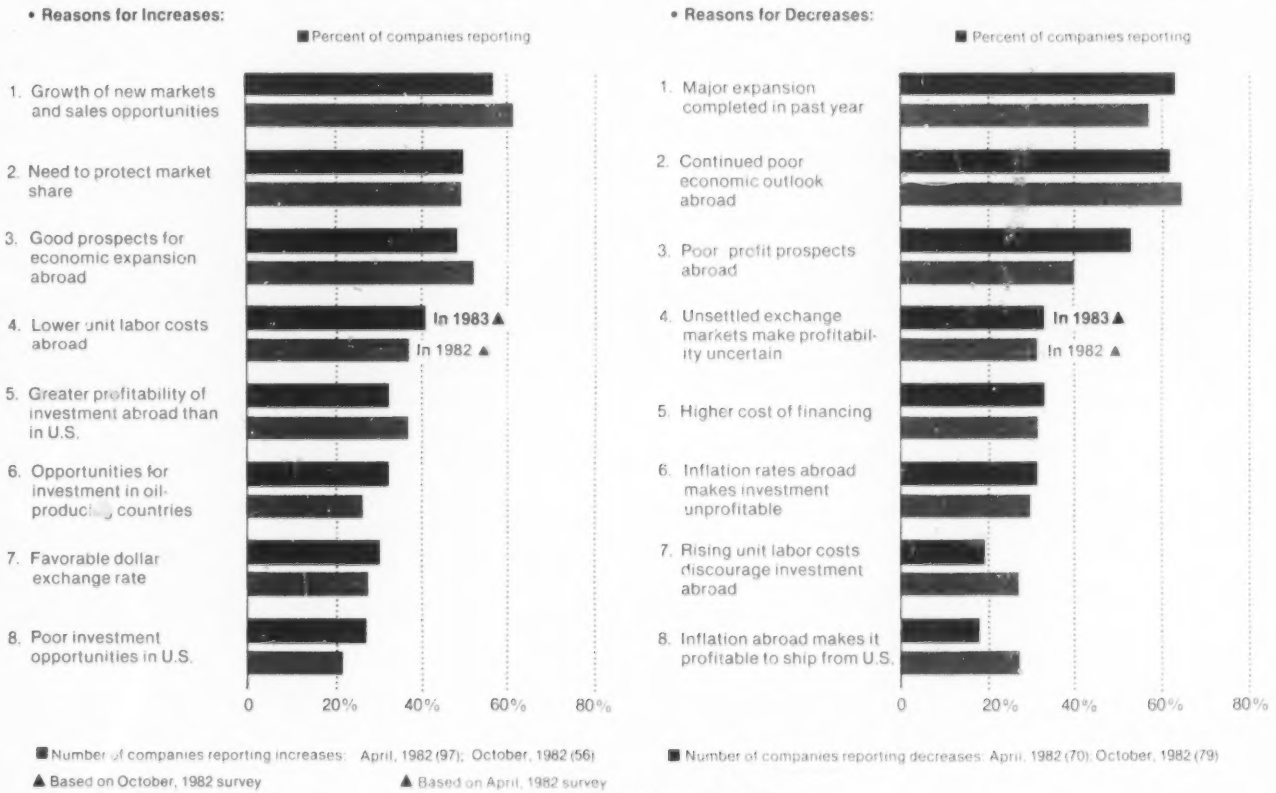
Spending Plans for Plant and Equipment Outside the United States by Industry

Percent of Companies Planning to Spend More



Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing


• Reasons for Increases:
Percent of companies reporting
1. Growth of new markets and sales opportunities
2. Need to protect market share
3. Good prospects for economic expansion abroad
4. Lower unit labor costs abroad
In 1983▲
In 1982 ▲
5. Greater profitability of investment abroad than in U.S.
6. Opportunities for investment in oil-producing countries
7. Favorable dollar exchange rate
8. Poor investment opportunities in U.S.
0
20%
40%
60%
80%
• Reasons for Decreases:
Percent of companies reporting
1. Major expansion completed in past year
2. Continued poor economic outlook abroad
3. Poor profit prospects abroad
4. Unsettled exchange markets make profitability uncertain
In 1983▲
In 1982 ▲
5. Higher cost of financing
6. Inflation rates abroad makes investment unprofitable
7. Rising unit labor costs discourage investment abroad
8. Inflation abroad makes it profitable to ship from U.S.
0
20%
40%
60%
80%

■ Number of companies reporting increases: April, 1982 (97); October, 1982 (56)

▲ Based on October, 1982 survey

▲ Based on April, 1982 survey

■ Number of companies reporting decreases: April, 1982 (70); October, 1982 (79)

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The Conference Board

Worldbusiness Perspectives No. 71
February 1983

FOREIGN MANUFACTURING INVESTMENT IN THE U.S.—
A Temporary Lull?

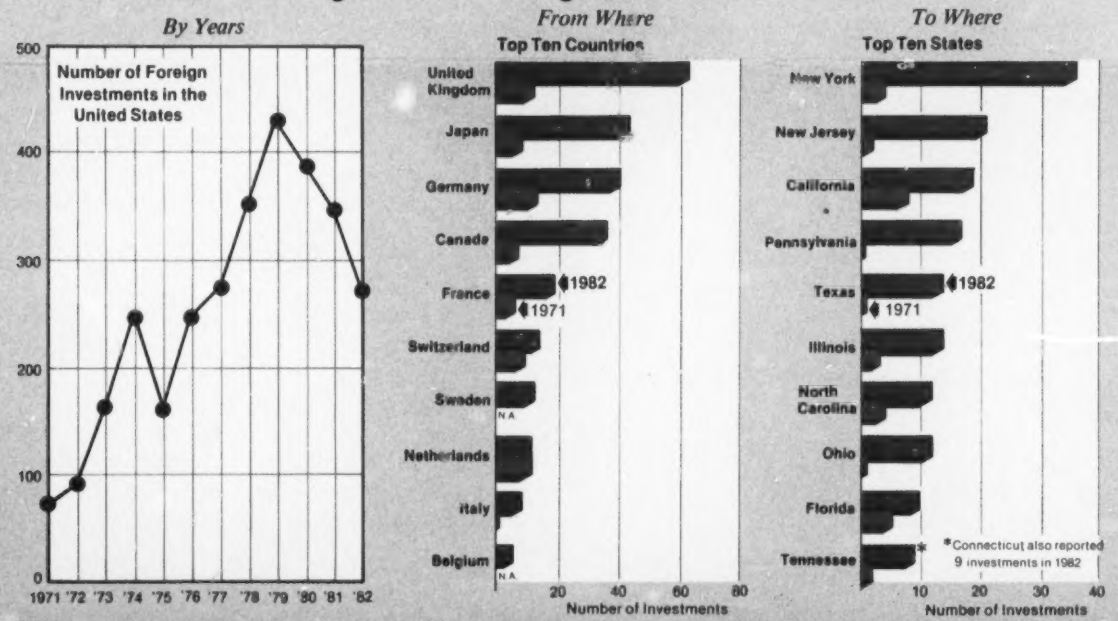
During the 1970's, the U.S. economy experienced a structural adjustment similar to that experienced by Europe in the 1960's—namely, a rapid increase in foreign direct investment. The parallel between the expansion of United States manufacturing activity in Europe twenty years ago and the recent growth of European, Canadian and Japanese firms in this country is, of course, not precise. A major difference is that foreign firms in the United States are not likely to capture large market shares in major industries as U.S. firms have done abroad. But the foreign presence in the United States is permanent, and will probably expand during the 1980's at a rate faster than that of the economy as a whole. The recent decline in the number of U.S. investments by foreign manufacturing companies appears to reflect the worldwide recession rather than any significant decline in the profit potential for foreign firms in the U.S. market.

Investment in 1982

Foreign companies announced that they are building, expanding or acquiring 271 manufacturing plants in the United States in 1982, according to a Conference Board tabulation. The number of investments announced last year was 22% below the 1981 level, and 38% below the 1979 mark of 434—which was the peak for the 12-year period for which Board figures are available

Spending figures available for 148 of the 271 investments announced last year total $2.7 billion. Foreign firms, as is the case with domestic companies, are not required to reveal the amount of money to be spent to construct or expand facilities, or to acquire

Number of Foreign Manufacturing Investments in the United States



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private companies. Foreign companies are required, however, to report the book value of their equity in their U.S. affiliates, as well as the net outstanding loans to affiliates. At the end of 1981 (latest available data), the cumulative value of investments by all foreign manufacturing firms in the United States was $30 billion.[1]

The decline in the number of investments announced since 1979 is in sharp contrast to the rapid growth that began in the early 1970's and marked the beginning of the post-World War II surge of investments in this country. Prior to this period, most firms chose to export to the United States rather than to establish U.S. production facilities. But, in 1971, the United States experienced its first merchandise trade deficit of the 20th century. Subsequent and larger deficits persuaded many foreign firms that increased U.S. tariffs and quotas would jeopardize the growth of United States sales, and that these sales could continue to grow only if U.S. production facilities were established.

At the same time that the possible loss of sales prompted consideration of U.S. plants, cost factors were also making the United States an increasingly attractive production site. The devaluation of the dollar in 1971 made the cost (in terms of foreign currency) of establishing U.S. facilities less expensive than in the 1960's; at the same time, the devaluation also raised the export price of goods sold to the United States. Additionally, foreign manufacturers were confronted with a jump in wage rates in their home countries that frequently outpaced U.S. increases. Between 1965 and 1975, for example, average compensation of U.S. manufacturing workers increased 80 percent. In Canada, Japan, Germany, the Netherlands, Sweden and the United Kingdom, the increases were 109 percent, 307 percent, 150 percent, 213 percent, 162 percent, and 207 percent, respectively. The Bureau of Labor Statistics estimates that in 1975, hourly compensation in three countries—Belgium ($6.60), the Netherlands ($6.53), and Sweden ($7.18) was above that in the United States ($6.35). In those countries where compensation was lower than in the United States, many manufacturers found that the cost of shipping and insurance eliminated the favorable compensation differential.

The decline in the number of foreign investments since 1979 appears to be attributable to the same factors that have caused U.S. firms to cut back on their expansion plans, namely, the sluggish and sometimes negative business activity of the past three years coupled with high interest rates. Along with the decline in new undertakings by foreign firms, a number of companies have closed some of their U.S. plants; in a few instances, production has been shifted back to the parent company or to third countries.

[1]U.S. Department of Commerce figures on direct foreign investment reflect financial flows between foreign parent companies and their U.S. subsidiaries. Readers interested in financial flows associated with foreign investments (rather than the number as reported by The Board) should consult the August, 1982, *Survey of Current Business*, a monthly publication of the U.S. Commerce Department.

Investment by Country

With the exception of Mexico, the largest foreign investors are also the major trading partners of the United States. In 1982, British firms announced 63 investments, followed by Japan (44), Germany (41), and Canada (37). The number of Japanese investments last year was only slightly below the 46 recorded in 1981, but investments from other countries dropped sharply.

U.S. Department of Commerce figures show that the Netherlands is the third largest investor (behind the United Kingdom and Canada) but the position of the Netherlands reflects massive investments by a very few firms, such as Shell and Unilever. The number of Dutch firms in the United States is, however, far below those of the countries mentioned above.

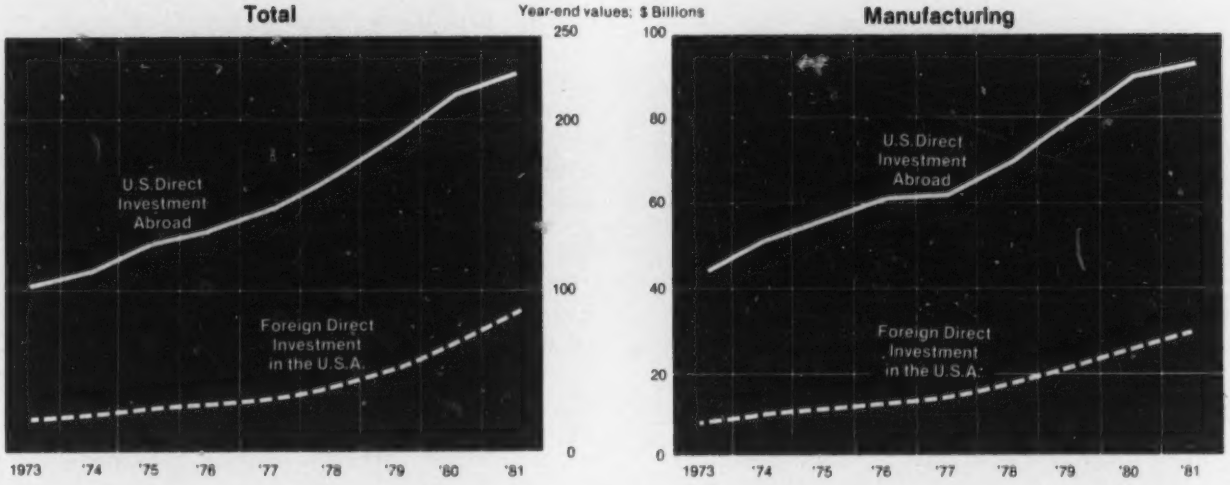
Direct investments by the OPEC nations in the U.S. manufacturing sector are relatively small although OPEC nations, primarily Kuwait and Saudi Arabia, have extremely large portfolio holdings. The direct investment position of Kuwait rose sharply in 1981. That country's government-owned petroleum company paid over $2.5 billion for Santa Fe International, a U.S. construction and oil and gas field services company.

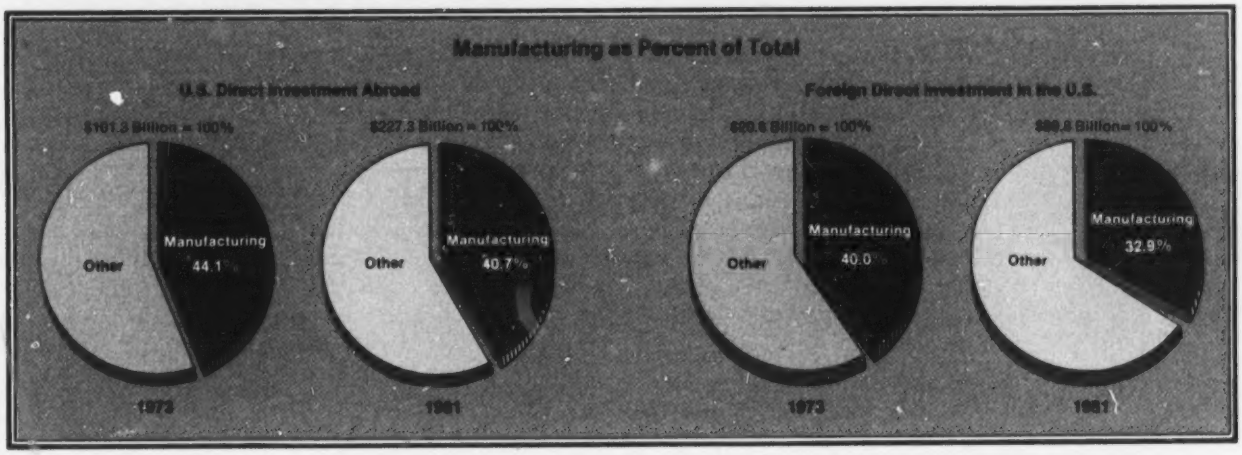
Investment by Type

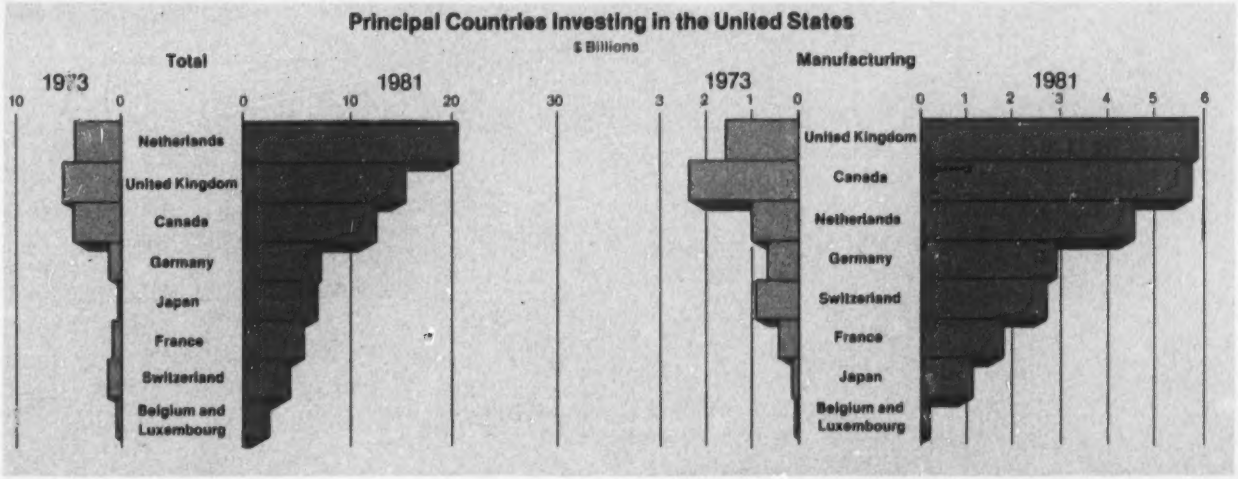
In 1982, 155 or nearly 60 percent, of all foreign manufacturing investments consisted of acquisitions. A decade ago, the ratio was about 20 percent. The increasing frequency of acquisitions is explained by several factors, one being the growing familiarity of foreign firms with the industrial structure of the U.S. economy. Investments made a decade ago were intended to establish a toehold in a unfamiliar market, and many firms felt that initial operations could be best conducted in facilities constructed to meet their individual requirements. Years of operating in the United States and a growing familarity with the manufacturing divisions and plants of U.S. companies have made acquisitions an alternative to construction when the need for capacity expansion arises. Last year, a proportionately large number of acquisitions occurred in the food, textiles, publishing, electrical machinery, and instrument industries.

The 155 acquisitions reported last year were down 14 percent from the 1981 total. In contrast, the number of decisions to build new plants (63) plunged 45 percent, although announcements to expand existing facilities held nearly steady at 57.

Direct Investment Position of the United States, 1973-81







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Investment by Industry

Four industries—food, chemicals, nonelectrical and electrical machinery—accounted for 60 percent of all manufacturing investments last year, a ratio not appreciably different from those of previous years. To date, foreign firms do not constitute a significantly large segment of any major (i.e., 2-digit) manufacturing industry in this country regardless of which yardstick—capital spending, output, employment or assets—is used. Within some industrial subsectors, however, foreign companies account for 10 percent or more of total U.S. output, among which are dystuffs, certain types of industrial gases, cement, pharmaceuticals, television sets, some manmade fibers, and various food products including biscuits and dehydrated soups.

Federal legislation limiting foreign investment will probably be proposed in Congress this year. The legislation, if enacted, would not be a complete ban on all investments. The legislation may, however, focus on defense goods and industries such as fiber optics. The legislation reflects concerns that industries important to this country's defense position and economic well-being should not have a large "foreign component." In some cases, the concern does not revolves around the actual production of a particular good, but rather centers on the development of technology related to the good.

To date, a major argument against restrictive legislation is that the foreign investment position of the United States ($227 billion in 1981, $92 billion of which was in manufacturing) far exceeds the foreign position in the United states ($89 billion total, $30 billion in manufacturing). The argument proceeds that the United States has far more to lose if other nations retaliate against restrictive measures adopted in this country. This argument, in turn, is countered by those who believe that other countries' existing policies are more restrictive than those of the United States, and that the legislation would redress an existing imbalance.

Investment by Area

Foreign investors have generally located their plants in the geographical areas favored by U.S. companies, although there are important exceptions. Some of the states that have a large concentration of mature industries have been successful in recruiting relatively large numbers of foreign companies. These states, which include Michigan, Ohio, Pennsylvania, Rhode Island, and Massachusetts, have been able to attract companies that require a large pool of highly skilled workers to produce industrial components and machinery, instruments and various types of electronic products. New York has capitalized on its skilled work force and its proximity to Canada to attract a large number of foreign companies.

Most of the states that are among the leaders in attracting foreign companies have mounted aggressive marketing programs featuring an array of financial and other incentives. The impact of these incentives on the foreign firm's decision concerning the geographical location of a plant is by no means clear. Most observers feel that few, if any, foreign firms have invested in the United States solely because of state-provided incentives, although at the margin incentives may be a factor for choosing one state over another. For many firms, however, a state outreach program that facilitates contacts between company executives and state officials has been more important than incentives in influencing locational decisions. A Federal Reserve Bank of Boston study of the locational decisions of foreign investors pointed up the importance of local attitudes to a prospective investment, noting that it was "clear from many selection histories that the reception given to visiting foreigners by state development officials, bankers and even restauranteurs and taxi drivers can be terribly important."

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The Conference Board

Worldbusiness Perspectives No. 72
April 1983

U.S. FOREIGN TRADE IN 1982
Slowing Economic Growth

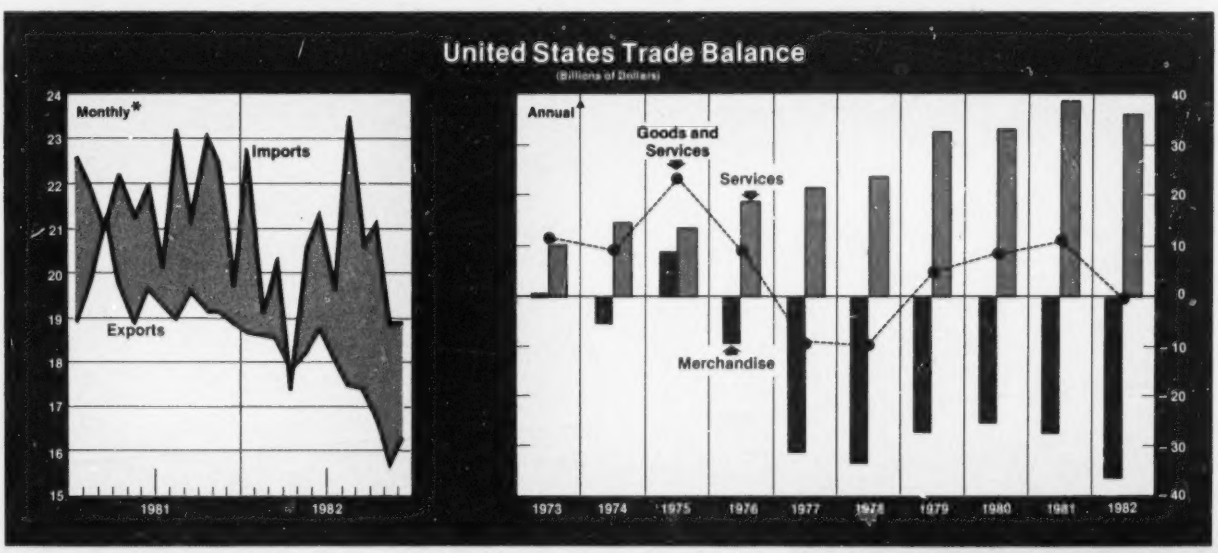
How powerfully the outside world impinges on the United States economy became amply clear in 1982, when U.S. merchandise exports fell for the first time in almost 25 years. That drop in exports—which in the national accounts translates into the somewhat more complex "net exports of goods and services"—was the single biggest factor in the decline of U.S. economic activity last year—substantially larger than the drop in housing activity, for instance. Repeated warnings that the decline in exports—which reflected both the strong dollar and the worldwide recession—might cost the country close to a full percentage point in annual GNP growth were borne out when the preliminary national account data for 1982 were released in late January.

Tallying 1982

At $31.8 billion, last year's U.S. trade deficit was the largest since 1978 and also showed the second annual increase in a row. The most significant element in the 1982 performance was the sharp swing in the trade balance in manufactured goods—traditionally a mainstay of the U.S. trade account—from a $11.8 billion surplus in 1981 to a $4.3 billion deficit last year. That deterioration of $16 billion—which followed a $7 billion decline in the balance on manufactures between 1980 and 1981—reflected, of course, the factors mentioned earlier, the overvalued dollar and the worldwide slump in economic activity.

Agricultural exports, at $37 billion, registered their first decline in seven years. This resulted from both record harvests and recession-reduced demand abroad, as well as a cut in the U.S. share of China's and the Soviet Union's overall grain import requirements.

These developments were offset, at least in part, by a sharp drop in petroleum imports. These fell from $76.7 billion in 1981 to $60.5 billion last year; volume dropped from 6.1 million barrels per day, at an average price



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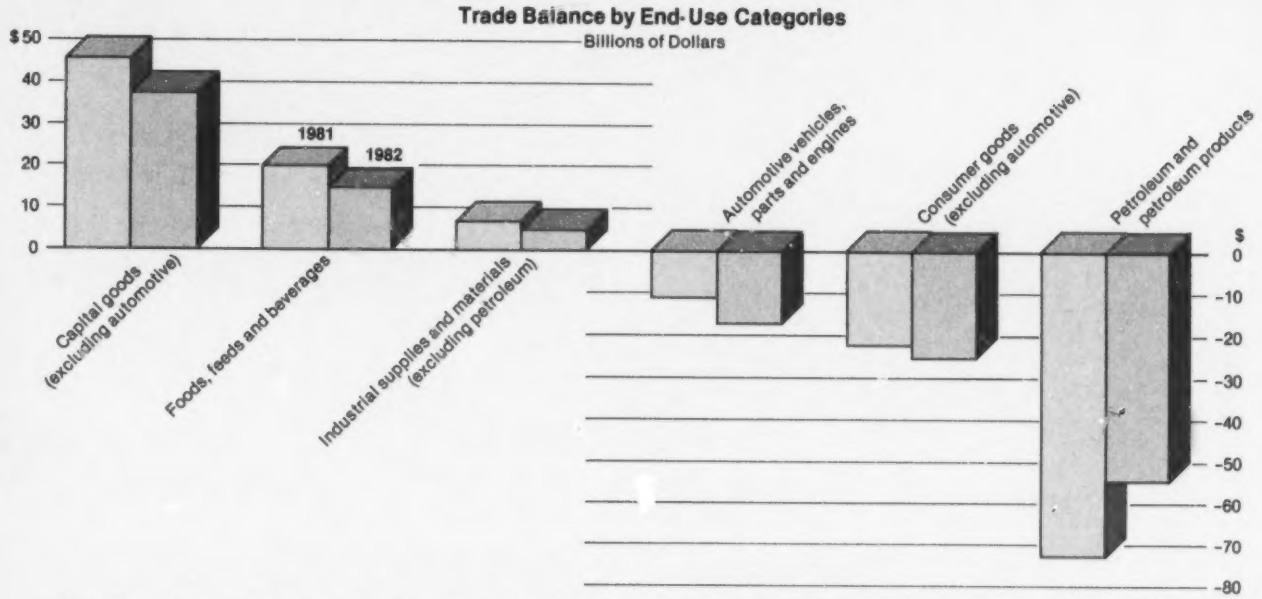


of $34.30, to 5.3 million barrels, at an average price of $31.48. (This past February, it might be noted, oil imports amounted to a mere 3.7 million barrels a day, the lowest level since some time in the 1960's, according to the Commerce Department. That decline produced a small *surplus* for the month in U.S. trade with OPEC.)

On a geographic basis, three major features stand out. First, as in previous years, the bulk of U.S. exports went to a relatively small number of markets. Eight countries accounted for half, and ten countries for almost three-fifths, of all U.S. exports (see table).

Second, these ten plus another dozen or so important customers constitute what one analyst has called "successful U.S. export targeting priorities"—the major industrial countries, a few major oil exporters, and several rapidly industrializing developing countries. Imports continued to be much more heavily concentrated, with five suppliers accounting for over half the total.

Ten Leading U.S. Trading Partners, 1982

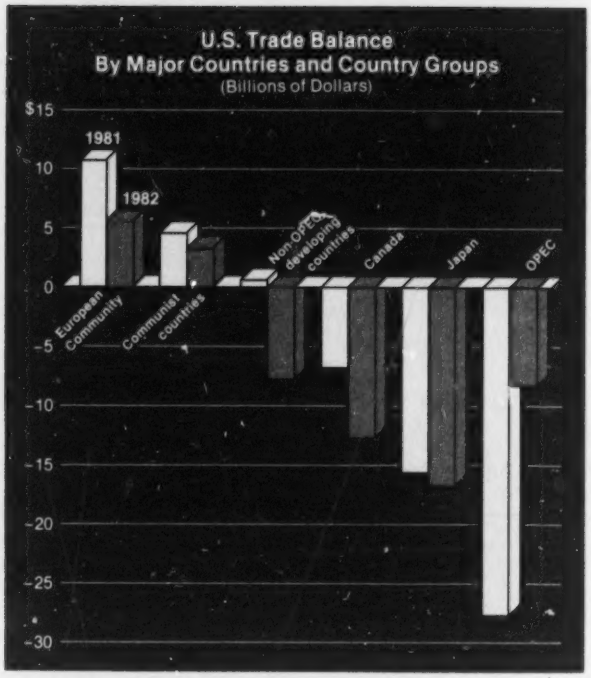
Exports		*Imports*	
Total	$212.2 bill.	Total	$244.0 bill.
1. Canada	15.9%	1. Canada	19.1%
2. Japan	9.9	2. Japan	15.5
3. Mexico	5.6	3. Mexico	6.4
4. United Kingdom	5.0	4. United Kingdom	5.4
5. Germany	4.4	5. Germany	4.9
6. Saudi Arabia	4.2		
7. Netherlands	4.1		51.3
8. France	3.3	6. Taiwan	3.6
	52.4	7. Saudi Arabia	3.0
		8. Nigeria	2.9
9. Korea	2.6	9. Korea	2.3
10. Belgium	2.5	10. France	2.2
	57.5%		65.3%

Third, last year set a new record for the U.S. trade deficit with Japan. At close to $17 billion, this was the largest deficit ever recorded with a single trading partner and accounted for well over half the global trade deficit for 1982. This development, which owed much to the overvaluation of the dollar vis-à-vis the Japanese yen (or the undervaluation of the latter), was responsible for several of the protectionist measures, such as the local-content bill for all cars sold in the United States, introduced toward the end of the 97th Congress. Indeed, as the chairman of a major U.S. corporation noted last November: "A yen in the 180-200 [per dollar] range would do more to end trade disputes than an increase in U.S. oil exports or even the lifting of Japan's remaining trade barriers."

More Red Ink for 1983

The U.S. trade deficit is expected to widen further this year, and current estimates are that the increase will be even larger than those of the past two years. While the world economy is expected to recover in 1983, that recovery may well be quite modest; moreover, foreign growth will tend to lag behind that in the United States. As a result, U.S. imports will turn up by much more (and sooner) than U.S. exports.

Another factor at work is that, in general, even similar rates of growth in the United States and abroad imply a declining balance in U.S. trade in manufactures. According to recent research by Robert Lawrence of the Brookings Institution, for each 1 percent increase in U.S. output, U.S. manufactured goods imports tend to increase by 3.1 percent. By contrast, for each 1 percent increase in output in the rest of the world, U.S. exports of manufactures tend to increase by only 1.3 percent. Thus, even if U.S. exports and imports of manufactured



goods initially were equal in value, to keep the balance from declining either the U.S. growth rate would have to be about one-third of that in the rest of the world or the relative price of U.S. goods would have to decline continuously.

The latter is quite unlikely. In fact, part of the deteriorating trade performance last year can be attributed to the continuing strength of the dollar—an influence that is likely to persist to some degree this year. Apart from the fact that the dollar—whose role was somewhat disputed and slightly shaky a few years back—will remain very much at the center of the world economic stage, some fundamentals, such as relatively higher interest rates and a decline in inflation, likewise augur for a continued strong dollar in 1983.

Of course, the approximate size of this year's trade deficit cannot be predicted at this time, since it depends on a host of factors—the margin by which U.S. growth exceeds that abroad; the relative strength of the dollar vis-a-vis other major currencies; the condition of world oil markets; crop conditions abroad; and the resolution of the developing countries' financial problems.

One negative factor that is fairly certain is the poor prospect for sales to non-OPEC developing countries which, as a group, account for over one-quarter of U.S. exports. The worldwide recession, declining commodity prices, and high interest rates have boosted the number of such countries with serious financial problems and led to cutbacks in their imports. For the United States, these developments have translated into an 11 percent drop in exports to the group as a whole last year; in the case of Mexico, our third most important market, exports fell by as much as one-third.

The OPEC countries are another imponderable. Faced with declining—or at least more slowly rising—oil revenues, this group also has had to scale down its import plans, with some members suffering more serious financial difficulties. Last year, U.S. exports to OPEC increased by only 6 percent, well below the more than 20 percent increase of the previous two years.

On the import side, one must keep in mind the projected upturns in consumer spending and residential construction in this country, two sectors that tend to absorb imported items. Also, the expected continued strength of the dollar will, as it did in 1982, confer significant price advantages on a number of foreign products.

Trade in Goods and Services

It is increasingly being stressed—and I have done so myself in this publication—that trade is only one, albeit an important, element in total U.S. international transactions. In recent years, it has, in fact, become more and more common when discussing international trade to speak of trade in goods and services rather than of merchandise trade alone. No wonder: The International Monetary Fund has estimated that the value of international services transactions more than doubled in the 1960's and that it grew by 17 percent annually in the 1970's, when merchandise trade increased by only 6 percent a year. Trade in services reached an estimated $650 billion worldwide in 1980, roughly equivalent to one-third the value of world merchandise exports. (For a listing of the major types of services, see box on page 4.)

* Changes in dollar rates vis-a-vis 15 major currencies, weighted by bilateral manufactures trade in 1976.

Services: Some Definitions

The major service industries whose products are "traded" internationally include accounting, advertising, banking, professional and technical services, communications, construction and engineering, education, information, insurance, legal services, motion pictures, tourism and transportation.

Popular discussion of the balance of payments often uses the terms "services" and "invisibles" interchangeably. Actually, the two concepts differ, with the latter being a more comprehensive one. In addition to services proper, invisibles comprise three categories—income on both direct investment (which includes, of course, some service industries, such as banking) and financial assets; official transfers; and private remittances. The right-hand chart on page 1 includes only services as enumerated above and investment income.

To date, no effort has been made to provide a general framework of rules to govern, let alone loosen the many barriers to, this substantial volume of international transactions, similar to the rules and codes covering merchandise dealings under the General Agreement on Tariffs and Trade (GATT). But it is being increasingly recognized that many services are in fact ancillary to the movement of goods, including cargo and passenger transport, cargo insurance, port services, and telecommunications. A second tier of services related to the provision of goods includes managerial and technical services and franchising. Or, as William Brock, the U.S. Special Trade Representative, has put it: "It is insane to think that you can long continue to trade in goods if you have barriers to the services which facilitate the trade in these goods. The two are totally intertwined, and you can't separate them."

The United States, which accounts for an estimated 15 percent of world trade in services, certainly has a vested interest in this issue. U.S. exports of services began exceeding $100 billion a year in 1979, and in six out of the past 10 years a strong showing on services account offset trade deficits and helped keep the overall U.S. balance of payments in surplus. It is interesting to note that last year the Department of Commerce began mentioning services for the first time in its monthly release on trade. In its discussion of the February, 1983, trade results the Department stated that "the report covers trade in merchandise only, excluding the trade in services that usually produces a surplus for the United States."

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The Conference Board

Worldbusiness Perspectives No. 73
June 1983

FOREIGN CAPITAL EXPENDITURES BY U.S. COMPANIES

A New Low in Expectations

Manufacturers continue to display unwillingness to spend abroad for plant and equipment, according to the latest survey conducted in April, 1983 by The Conference Board. Only slightly more than a fifth of the respondents replied that they planned to spend more abroad in 1983 than in the prior year. This percentage is even lower than in the October, 1982 survey, when manufacturers were asked the same question, and thus sets a new low in expectations. In October, 1982, about one-quarter of the respondents expected to spend more in 1983 than in the prior year.

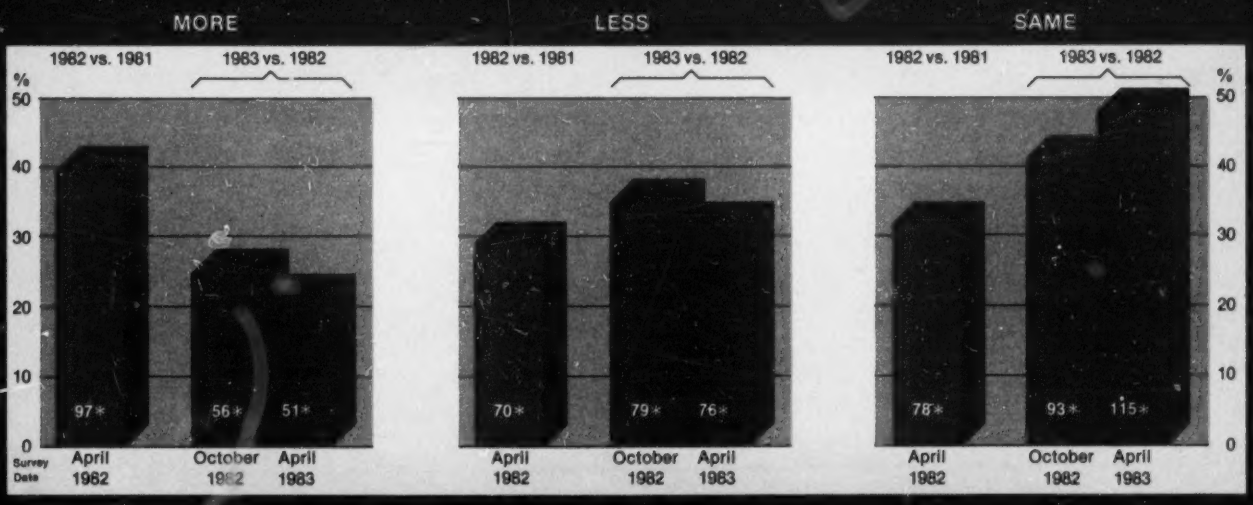
As a result of the continued pessimism, the recorded percentage of companies planning to spend more abroad in the latest survey is only about half of the level that was reported only a year ago in the survey of April, 1982. Moreover, the present survey continues the downward slide that emerged after the survey of April, 1979. At that time, more than half of the companies (52 percent) expected to spend more in 1979 than in the year before.

The survey conducted by The Conference Board is aimed only at comparing the direction of current investment intentions with past levels on a company-by-company basis, without seeking dollar magnitudes. In the December, 1982, survey by the Department of Commerce (the latest aimed at reaching dollar magnitudes), manufacturers (including petroleum companies) stated that their 1983 expenditures on plant and equipment were expected to be $34 billion, about the same level as in 1982. The April, 1983 Conference Board survey confirms that expectation. If any change is likely, it will be in the direction of lower 1983 expenditures.

J. Frank Gaston

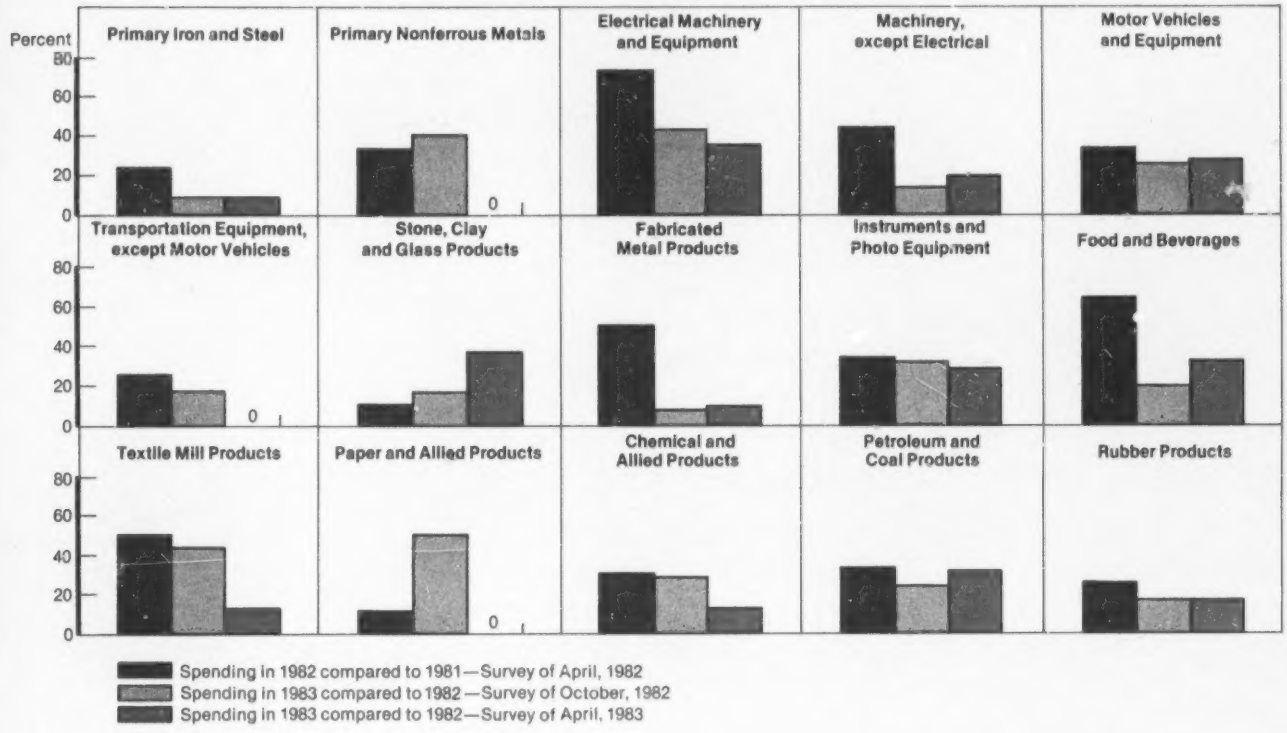
Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend

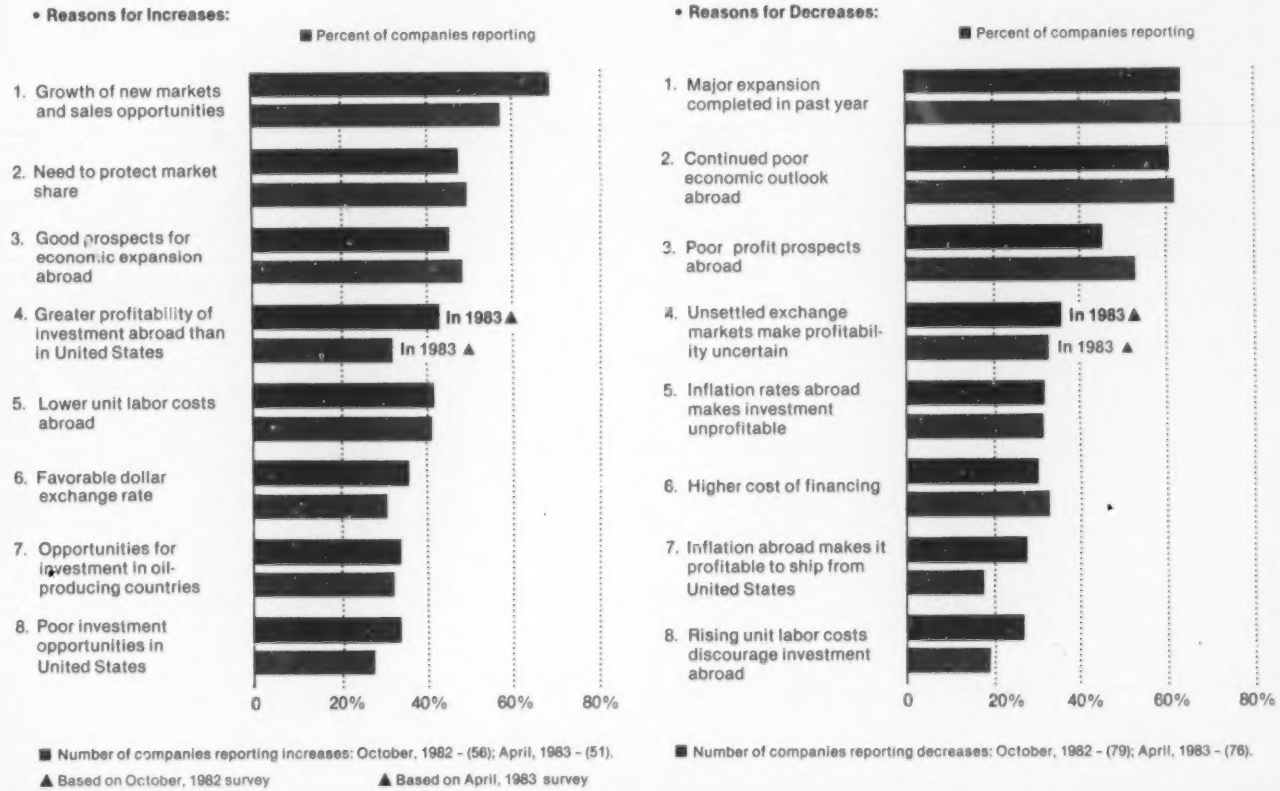


Spending Plans for Plant and Equipment Outside the United States by Industry

Percent of Companies Planning to Spend More



Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing


• Reasons for Increases:
Percent of companies reporting
1. Growth of new markets and sales opportunities
2. Need to protect market share
3. Good prospects for economic expansion abroad
4. Greater profitability of investment abroad than in United States
5. Lower unit labor costs abroad
6. Favorable dollar exchange rate
7. Opportunities for investment in oil-producing countries
8. Poor investment opportunities in United States
In 1983▲
In 1983 ▲
0
20%
40%
60%
80%
■ Number of companies reporting increases: October, 1982 - (56); April, 1983 - (51).
▲ Based on October, 1982 survey
▲ Based on April, 1983 survey
• Reasons for Decreases:
Percent of companies reporting
1. Major expansion completed in past year
2. Continued poor economic outlook abroad
3. Poor profit prospects abroad
4. Unsettled exchange markets make profitability uncertain
5. Inflation rates abroad makes investment unprofitable
6. Higher cost of financing
7. Inflation abroad makes it profitable to ship from United States
8. Rising unit labor costs discourage investment abroad
In 1983▲
In 1983 ▲
0
20%
40%
60%
80%
■ Number of companies reporting decreases: October, 1982 - (79); April, 1983 - (76).

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The Conference Board

Worldbusiness Perspectives No. 74
August 1983

THE LABOR-COST CONNECTION IN FOREIGN TRADE

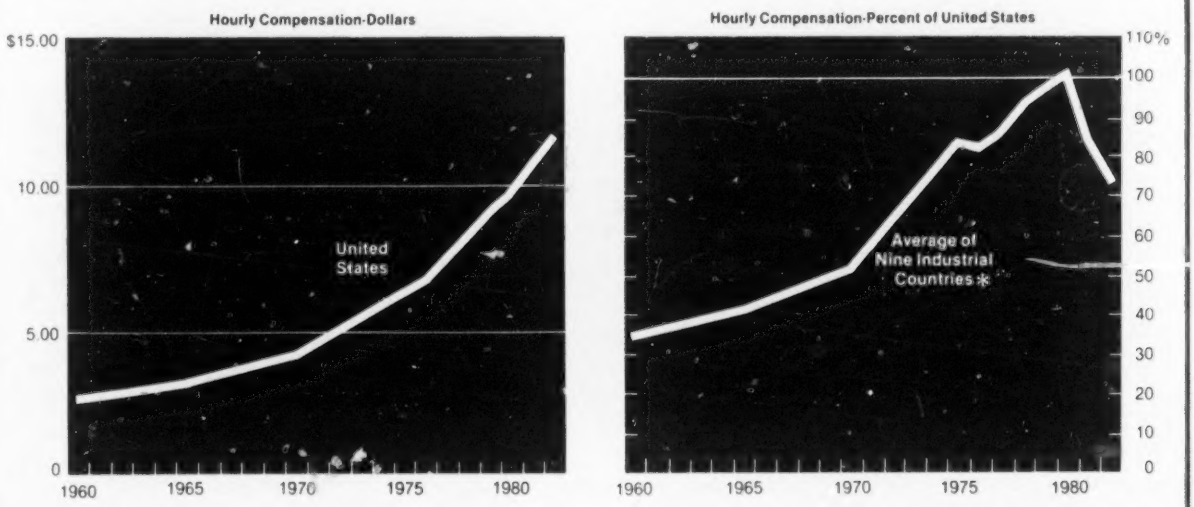
The foreign trade of the United States has recently displayed a new feature that may have far-reaching implications for its competitive position. In 1982, the United States showed a substantial deficit of $4.3 billion in its balance of trade on manufactured goods. The deficit continued and, as a matter of fact, expanded enormously in the first half of 1983 to an adverse balance of trade of manufactured goods of $11 billion. The only previous time in recent history that such a deficit was recorded was in 1978.

Trade in manufactured goods rests upon a different basis than that in fuels and raw materials. The source of the latter is determined in large part by a fortuitous act of nature. But many countries are currently capable of making a variety of manufactured goods. Moreover, the development of new products and new processes can change the relative advantage that one country has over another in finding international markets.

Another major factor in the successful international marketing of manufactured products are comparative costs, of which comparative labor costs are a significant component. The generally favorable labor costs that the United States enjoyed up to 1980 has recently been slipping, accounting in part for the emerging trade deficits in manufactured goods.

A deficit in our overall foreign trade (manufactured and other merchandise combined) is not a new development. Going back to at least 1971, the United States has had such a trade deficit more often than we have had a surplus. This experience represents a sharp reversal of the one prior to 1971, when we typically had surpluses of merchandise exports over imports.

U.S. Hourly Compensation in Manufacturing Compared with Average of Nine other Industrial Countries



*Countries identified in following chart

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The overall deficit that we have been experiencing in the last 12 years is attributed primarily to the establishment of OPEC as a dominant market factor, the consequent running up of petroleum prices, and the inability of the United States to supply enough petroleum for its needs from domestic sources. Industry and consumers were geared to the ready availability of petroleum products and did not, or could not, change their consumption habits easily. So, while conservation was urged upon the nation, the effects of such restraints on our imports of petroleum products were not felt until 1981. Since source of supply is the prime factor in determining where purchases of petroleum can be made, there was little room for maneuverability by the United States.

Changing Role of Trade in Manufactures

As a result, the United States experienced steady substantial deficits on overall merchandise trade. In the years 1977 through 1982, we had an annual average excess of merchandise imports over exports of approximately $28.5 billion. As substantial as this deficit was, it would have been even larger had we not been able to maintain a substantial surplus on our balance of trade of manufactured items. (See Worldbusiness Perspectives No. 72, April, 1983.)

It now appears, however, that this means of offsetting the financial impact of huge imports of petroleum products is eroding. Whether the emerging adverse trend in manufactured products will continue remains to be seen, of course. One of the important factors in the international competitive position concerning the ability to sell manufactured products is costs and, in particular, labor costs. Precise data are not available to measure the unit costs of manufactured products, so any examination of this factor must be made indirectly. As an approximation, one can make tentative use of available data on hourly compensation in manufacturing, a collection of data that has been regularly developed by the United States Department of Labor for a number of countries, but not regularly published. (Hourly compensation comes close to measuring the total time cost of labor. Since it does not take productivity into account, it cannot be regarded as a measure of unit labor costs. Hourly compensation is made up of pay for time worked plus overtime premiums, shift differentials, other bonuses and premiums paid regularly, and cost-of-living adjustments before payroll deductions for income taxes, social security, insurance, savings plans, or union dues. It includes pay for vacations, holidays and other leaves, employer contributions to legally required insurance programs and contractual and private benefit plans).

U.S. Merchandise Exports and Imports of Manufactures, 1960, 1965, 1970, 1975-1983
$ Billions

	Exports of Manufactures F.A.A. Value	*Imports of Manufactures Customs Value*	*Balance on Export and Imports of Manufactures*
1960	$ 12.6	$ 6.9	$ 5.7
1965	17.4	11.2	6.2
1970	29.3	25.9	3.4
1975	71.0	51.1[a]	19.9
1976	77.2	64.8[a]	12.4
1977	80.2	76.6[a]	3.6
1978	94.5	100.3[a]	-5.8
1979	116.6	112.2[a]	4.4
1980	143.9	125.1[a]	18.8
1981	154.3	142.5	11.8
1982	139.7	144.0	-4.3
1983-1st half	65.5	76.7	-11.2

[a]F.A.S. value

Source: Council of Economic Advisers

Behavior of Labor Costs

In all countries, such costs have risen over the last decade, in some more than in others. The rise that occurs in terms of the national currency may be amplified or damped by the expression of such costs in terms of a common currency. The fluctuation of the foreign exchange value of its currency can thus alter the comparative cost position of a country.

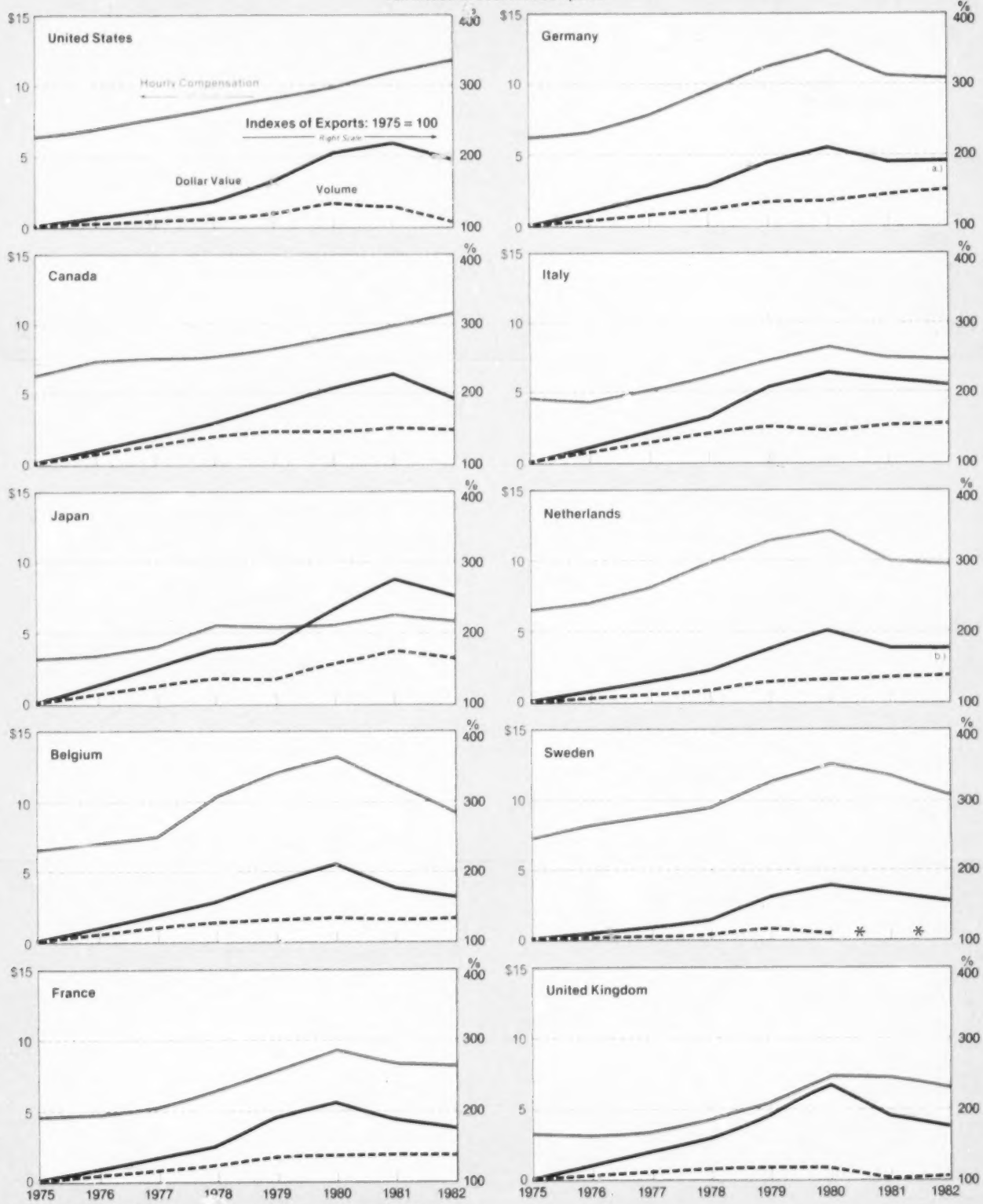
Hourly compensation has risen rapidly in the United States: By 1982, such costs were more than four times the 1960 level. As substantial as that rise has been, similar costs in other countries (in dollars) have risen even more rapidly. Consequently, by 1980, the average for the nine industrial countries was equal to such costs in the United States. That year also marked a dividing line: The average of hourly compensation in the nine industrial countries rose in the preceding 20 years compared with such costs in the United States. Since that time, such costs have fallen so that they were approximately 74% of the 1982 United States level.

Two factors are at work in changing the position of the United States and the other principal industrial countries. In the first instance, compensation expressed in national currency rose in the nine industrial countries at a much faster rate than in the United States in the 20 years between 1960 and 1980. Second, this was a period in which most industrial countries saw their currencies appreciate in terms of the United States dollar. The effect of such appreciation, of course, was to raise even further the dollar costs of their manufactured goods.

It is to be expected that these substantial swings in labor-cost relationships would have a pronounced effect on export performance, particularly of manufactured goods. Tracing the relationship, however, is not a simple matter. Part of the reason is that a variety of

Hourly Compensation and Export Performance in Manufacturing, 1975-1982

Ten Industrial Countries Compared



a.) Estimated for year based upon first 3 quarters. b.) Estimated for year based upon first 3 quarters

*Not available

factors interact to result in expanded or shrunken exports; assigning a cause is always a questionable matter.

Experience of the United States

In the case of some countries—the United States, for example—the export performance seems to be in line with commonsense expectations. Our surplus of manufactured goods flourished when foreign labor costs were catching up to ours in the period form 1960 to 1980. Since 1980, with generally declining costs of our principal industrial competitors, our export performance seems to have deteriorated.

In the period leading up to 1980, the exports of the nine industrial competitors of the United States also expanded. As a matter of fact, most of these increased their exports (in dollars) more rapidly than did the United States. Part of this increase is due to the appreciation of foreign currencies in terms of the dollar. A fixed value of exports (originally denominated in national currency) from a foreign country will carry a higher value when expressed in dollars as a result of currency appreciation. In other words, the simple mechanics of converting all exports to a common currency—the dollar—has the effect of raising values under such circumstances.

But, of course, there is more to it because the record shows that the exports of these nine industrial countries also increased substantially when expressed in terms of volume. As a matter of fact, the volume exports of most of the nine showed a faster rise than such exports from the United States. Only the United Kingdom and Sweden have performed comparatively poorly. The Netherlands has not done as well as the United States, if the comparison is confined to the 1975-1980 period, but has outperformed the United States if a longer time period is considered.

Yet in the years leading up to 1980, labor costs, as measured by hourly compensation in manufacturing, increased faster in the other nine than in the United States. As shown in the first chart, the competitors' advantage in hourly costs that prevailed during the 1960's was rapidly dissipated, and by 1980 such money costs were on a par with those in the United States.

Hourly Compensation and unit Labor Costs

Hourly compensation in manufacturing cannot be automatically converted into unit labor costs, since they take no account of productivity. However, the levels of hourly compensation in manufacturing do not appear to be contradicted by other existing related data—information on the change in unit labor costs over the same period. These data take account of the changes in output, in total hours of employment, and in hourly compensation to arrive at a measure of change in unit labor costs. But these indexes cannot provide any insight into the comparative level of labor costs. In any case, in all the industralized countries, except Canada, unit costs moved up faster than in the United States. This is the same conclusion that one would draw from the data on hourly compensation in manufacturing.

What impact has the drop in wage costs had upon exports of the nine industrial competitors? Exports in virtually all countries have dropped in the 1980-1982 period when the values are denominated in dollars. However, this is primarily a result of the fact that the currencies of most countries have depreciated at the same time, so that fixed quantities of exports are, in fact, translated into a smaller dollar value than before.

By contrast, when export volume is examined, most of the industrial countries (except the United States and the United Kingdom) have been able to increase the volume of their exports throughout this period. As a matter of fact, volume appears to expand more or less in line with experience in the period prior to 1980.

This varied experience in the volume of exports raises a question about the role played by labor costs in the export experience of industrial countries. During the years leading up to 1980, the exports of all countries rose—whether expressed in dollar or in volume. In terms of volume, the exports of a number of countries rose faster than those of the United States. Yet this was the period during which their hourly compensation costs rose faster than in the United States—so much so that by 1980 the levels were equal. Their faster rising costs did not prevent their expanding exports.

The period since 1980 shows a somewhat different picture. During this time, the labor-cost relationship turned against the United States and export volume declined. The comparative labor-cost position of most of the nine industrial competitors improved and their export volume held up. In other words, it appears that the other countries were able to expand their exports when costs were moving against them as well as when costs were moving in their favor.

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